

105TH CONGRESS
1ST SESSION

H. R. 1584

To amend the Internal Revenue Code of 1986 to provide all taxpayers with a 50 percent deduction for capital gains, to index the basis of certain capital assets, to provide credits for families, to phase-out the estate and gift taxes, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MAY 13, 1997

Mr. SAM JOHNSON of Texas (for himself, Mr. BURTON of Indiana, Mr. TIAHRT, Mr. BARR of Georgia, Mr. CRANE, Mr. POMBO, Mr. LEWIS of Kentucky, Mr. HOSTETTLER, Mr. SESSIONS, Mr. CHABOT, Mr. BOB SCHAFER of Colorado, and Mr. GRAHAM) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to provide all taxpayers with a 50 percent deduction for capital gains, to index the basis of certain capital assets, to provide credits for families, to phase-out the estate and gift taxes, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Tax Freedom for Fam-
5 ilies Act of 1997”.

1 **TITLE I—INCENTIVES FOR CAP-**
2 **ITAL FORMATION AND JOBS**
3 **CREATION**

4 **SEC. 101. 50 PERCENT CAPITAL GAINS DEDUCTION.**

5 (a) GENERAL RULE.—Section 1201 of the Internal
6 Revenue Code of 1986 is amended to read as follows:

7 **“SEC. 1201. CAPITAL GAINS DEDUCTION.**

8 “(a) GENERAL RULE.—If for any taxable year a tax-
9 payer has a net capital gain, 50 percent of such gain shall
10 be a deduction from gross income.

11 “(b) ESTATES AND TRUSTS.—In the case of an es-
12 tate or trust, the deduction shall be computed by excluding
13 the portion (if any) of the gains for the taxable year from
14 sales or exchanges of capital assets which, under sections
15 652 and 662 (relating to inclusions of amounts in gross
16 income of beneficiaries of trusts), is includible by the in-
17 come beneficiaries as gain derived from the sale or ex-
18 change of capital assets.

19 “(c) COORDINATION WITH TREATMENT OF CAPITAL
20 GAIN UNDER LIMITATION ON INVESTMENT INTEREST.—
21 For purposes of this section, the net capital gain for any
22 taxable year shall be reduced (but not below zero) by the
23 amount which the taxpayer takes into account as invest-
24 ment income under section 163(d)(4)(B)(iii).

25 “(d) TRANSITIONAL RULES.—

1 “(1) IN GENERAL.—In the case of a taxable
2 year which includes January 1, 1997—

3 “(A) the amount taken into account as the
4 net capital gain under subsection (a) shall not
5 exceed the net capital gain determined by only
6 taking into account gains and losses properly
7 taken into account for the portion of the tax-
8 able year on or after January 1, 1997, and

9 “(B) the amount of the net capital gain
10 taken into account in applying section 1(h) for
11 such year shall be reduced by the amount taken
12 into account under subparagraph (A) for such
13 year.

14 “(2) SPECIAL RULES FOR PASS-THRU ENTI-
15 TIES.—

16 “(A) IN GENERAL.—In applying paragraph
17 (1) with respect to any pass-thru entity, the de-
18 termination of when gains and losses are prop-
19 erly taken into account shall be made at the en-
20 tity level.

21 “(B) PASS-THRU ENTITY DEFINED.—For
22 purposes of subparagraph (A), the term ‘pass-
23 thru entity’ means—

24 “(i) a regulated investment company,

25 “(ii) a real estate investment trust,

1 “(iii) an S corporation,

2 “(iv) a partnership,

3 “(v) an estate or trust, and

4 “(vi) a common trust fund.”

5 (b) DEDUCTION ALLOWABLE IN COMPUTING AD-
6 JUSTED GROSS INCOME.—Subsection (a) of section 62 of
7 such Code is amended by inserting after paragraph (16)
8 the following new paragraph:

9 “(17) LONG-TERM CAPITAL GAINS.—The de-
10 duction allowed by section 1201.”

11 (c) TECHNICAL AND CONFORMING CHANGES.—

12 (1)(A) Section 1 of such Code is amended by
13 striking subsection (h).

14 (B) Subsection (a) of section 1202 of such Code
15 amended to read as follows:

16 “(a) MAXIMUM CAPITAL GAINS RATE FOR CERTAIN
17 SMALL BUSINESS STOCK.—

18 “(1) IN GENERAL.—If for any taxable year a
19 taxpayer other than a corporation has gain from the
20 sale or exchange of any qualified small business
21 stock held for more than 5 years, then the tax im-
22 posed by section 1 shall not exceed the sum of—

23 “(A) a tax computed under section 1 on
24 the taxable income reduced by $\frac{1}{2}$ the amount of
25 the small business gain, at the rates and in the

1 manner as if this subsection had not been en-
2 acted, plus

3 “(B) a tax of 14 percent of the small busi-
4 ness gain.

5 “(2) SMALL BUSINESS GAIN.—For purposes of
6 paragraph (1), the term ‘small business gain’ means
7 the lesser of—

8 “(A) gain from the sale or exchange of any
9 qualified small business stock held for more
10 than 5 years, or

11 “(B) the net capital gain taken into ac-
12 count under section 1201(a).”

13 (2) Section 12 of such Code is amended by
14 striking paragraph (4) and redesignating the follow-
15 ing paragraphs accordingly.

16 (3)(A) Subsection (a) of section 57 of such
17 Code is amended by striking paragraph (7).

18 (B) Subclause (II) of section 53(d)(1)(B)(ii) of
19 such Code is amended by striking “, (5), and (7)”
20 and inserting “and (5)”.

21 (4) Paragraph (1) of section 170(e) of such
22 Code is amended by striking “the amount of gain”
23 in the material following subparagraph (B)(ii) and
24 inserting “50 percent of the amount of gain”.

1 (5) Paragraph (2) of section 172(d) of such
2 Code is amended to read as follows:

3 “(2) CAPITAL GAINS AND LOSSES.—

4 “(A) LOSSES OF TAXPAYERS OTHER THAN
5 CORPORATIONS.—In the case of a taxpayer
6 other than a corporation, the amount deductible
7 on account of losses from sales or exchanges of
8 capital assets shall not exceed the amount in-
9 cludible on account of gains from sales or ex-
10 changes of capital assets.

11 “(B) DEDUCTION FOR CAPITAL GAINS.—

12 The deduction under section 1201 shall not be
13 allowed.”

14 (6) The last sentence of section 453A(c)(3) of
15 such Code is amended by striking all that follows
16 “long-term capital gain,” and inserting “the deduc-
17 tion under section 1201 shall be taken into ac-
18 count.”.

19 (7) Paragraph (2) of section 468B(b) of such
20 Code is amended by inserting “the deduction allowed
21 by section 1201 and by” after “reduced by”.

22 (8) Paragraph (2) of section 527(b) of such
23 Code is hereby repealed.

1 (9) Subparagraph (A) of section 641(d)(2) of
2 such Code is amended by striking “Except as pro-
3 vided in section 1(h), the” and inserting “The”.

4 (10) Paragraph (4) of section 642(c) of such
5 Code is amended to read as follows:

6 “(4) ADJUSTMENTS.—To the extent that the
7 amount otherwise allowable as a deduction under
8 this subsection consists of gain from the sale or ex-
9 change of capital assets held for more than 1 year,
10 proper adjustment shall be made for any deduction
11 allowable to the estate or trust under section 1201
12 (relating to capital gains deduction). In the case of
13 a trust, the deduction allowed by this subsection
14 shall be subject to section 681 (relating to unrelated
15 business income).”

16 (11) The last sentence of section 643(a)(3) of
17 such Code is amended to read as follows: “The de-
18 duction under section 1201 (relating to capital gains
19 deduction) shall not be taken into account.”

20 (12) Subparagraph (C) of section 643(a)(6) of
21 such Code is amended by inserting “(i)” before
22 “there shall” and by inserting before the period “,
23 and (ii) the deduction under section 1201 (relating
24 to capital gains deduction) shall not be taken into
25 account”.

1 (13) Paragraph (4) of section 691(c) of such
2 Code is amended by striking “1(h),”.

3 (14) Paragraph (2) of section 801(a) of such
4 Code is hereby repealed.

5 (15) Subsection (c) of section 831 of such Code
6 is amended by striking paragraph (1) and redesignig-
7 nating the following paragraphs accordingly.

8 (16)(A) Subparagraph (A) of section 852(b)(3)
9 of such Code is amended by striking “, determined
10 as provided in section 1201(a), on” and inserting
11 “of 17.5 percent of”.

12 (B) Clause (iii) of section 852(b)(3)(D) of such
13 Code is amended—

14 (i) by striking “65 percent” and inserting
15 “82.5 percent”, and

16 (ii) by striking “section 1201(a)” and in-
17 serting “subparagraph (A)”.

18 (17) Clause (ii) of section 857(b)(3)(A) of such
19 Code is amended by striking “determined at the rate
20 provided in section 1201(a) on” and inserting “of
21 17.5 percent of”.

22 (18) The second sentence of section 871(a)(2)
23 of such Code is amended by striking “1202” and in-
24 serting “1201”.

1 (19) Paragraph (1) of section 882(a) of such
2 Code is amended by striking “section 11, 55, 59A,
3 or 1201(a)” and inserting “section 11, 55, or 59A”.

4 (20)(A) Paragraph (2) of section 904(b) of
5 such Code is amended to read as follows:

6 “(2) CAPITAL GAINS.—Taxable income from
7 sources outside the United States shall include gain
8 from the sale or exchange of capital assets only to
9 the extent of foreign source capital gain net in-
10 come.”.

11 (B) Paragraph (3) of section 904(b) of such
12 Code is amended by striking subparagraphs (B),
13 (D), and (E) and by redesignating subparagraph (C)
14 as subparagraph (B).

15 (21)(A) Paragraph (2) of section 1211(b) of
16 such Code is amended to read as follows:

17 “(2) the sum of—

18 “(A) the excess of the net short-term cap-
19 ital loss over the net long-term capital gain, and

20 “(B) one-half of the excess of the net long-
21 term capital loss over the net short-term capital
22 gain.”

23 (B) So much of paragraph (2) of section
24 1212(b) of such Code as precedes subparagraph (B)
25 thereof is amended to read as follows:

1 “(2) SPECIAL RULES.—

2 “(A) ADJUSTMENTS.—

3 “(i) For purposes of determining the
4 excess referred to in paragraph (1)(A),
5 there shall be treated as short-term capital
6 gain in the taxable year an amount equal
7 to the lesser of—

8 “(I) the amount allowed for the
9 taxable year under paragraph (1) or
10 (2) of section 1211(b), or

11 “(II) the adjusted taxable income
12 for such taxable year.

13 “(ii) For purposes of determining the
14 excess referred to in paragraph (1)(B),
15 there shall be treated as short-term capital
16 gain in the taxable year an amount equal
17 to the sum of—

18 “(I) the amount allowed for the
19 taxable year under paragraph (1) or
20 (2) of section 1211(b) or the adjusted
21 taxable income for such taxable year,
22 whichever is the least, plus

23 “(II) the excess of the amount
24 described in subclause (I) over the net
25 short-term capital loss (determined

1 without regard to this subsection) for
2 such year.”

3 (C) Subsection (b) of section 1212 is amended
4 by adding at the end the following new paragraph:

5 “(3) TRANSITIONAL RULE.—

6 “(A) IN GENERAL.—The amount deter-
7 mined under subclause (II) of paragraph
8 (2)(A)(ii) for any taxable year shall be reduced
9 (but not below zero) by the excess of—

10 “(i) the amount of the unused pre-
11 1998 long-term capital loss for such year,
12 over

13 “(ii) the sum of the long-term capital
14 gain and the net short-term capital gain
15 for such taxable year.

16 Section 1211(b)(2)(B) shall be applied without
17 regard to ‘one-half of’ with respect to such ex-
18 cess for such taxable year.

19 “(B) UNUSED PRE-1998 LONG-TERM CAP-
20 ITAL LOSS.—For purposes of this paragraph,
21 the term ‘unused pre-1998 long-term capital
22 loss’ means, with respect to a taxable year, the
23 excess of—

24 “(i) the amount which under para-
25 graph (1)(B) (as in effect for taxable years

beginning before January 1, 1998) is treated as a long-term capital loss for the taxpayer's first taxable year beginning after December 31, 1997, over

“(ii) the sum of—

“(I) the aggregate amount determined under subparagraph (A)(ii) for all prior taxable years beginning after December 31, 1997, and

“(II) the aggregate reductions under subparagraph (A) for all such prior taxable years.”

(22) Subsection (b) of section 1374 of such Code is amended by striking paragraph (4).

(23) Subsection (b) of section 1381 is amended by striking “or 1201”.

(24) Paragraph (1) of section 1402(i) of such Code is amended by inserting “, and the deduction provided by section 1201 shall not apply” before the period at the end thereof.

(25) Subsection (e) of section 1445 of such Code is amended—

(A) in paragraph (1) by striking “35 percent (or, to the extent provided in regulations, 28 percent)” and inserting “17.5 percent (or, to

1 the extent provided in regulations, 19.8 per-
2 cent)”, and

3 (B) in paragraph (2) by striking “35 per-
4 cent” and inserting “17.5 percent”.

5 (26) Clause (i) of section 6425(c)(1)(A) of such
6 Code is amended by striking “or 1201(a)”.

7 (27) Clause (i) of section 6655(g)(1)(A) of such
8 Code is amended by striking “or 1201(a)”.

9 (28)(A) The second sentence of section
10 7518(g)(6)(A) of such Code is amended—

11 (i) by striking “during a taxable year to
12 which section 1(h) or 1201(a) applies”, and

13 (ii) by striking “28 percent (34 percent”
14 and inserting “19.8 percent (17.5 percent”.

15 (B) The second sentence of section
16 607(h)(6)(A) of the Merchant Marine Act, 1936 is
17 amended—

18 (i) by striking “during a taxable year to
19 which section 1(h) or 1201(a) of such Code ap-
20 plies”, and

21 (ii) by striking “28 percent (34 percent”
22 and inserting “19.8 percent (17.5 percent”.

23 (29) The section heading for section 1202 is
24 amended to read as follows:

1 **“SEC. 1202. SMALL BUSINESS STOCK ELIGIBLE FOR PREF-**
2 **ERENTIAL RATE.”**

3 (30) The table of sections for part I of sub-
4 chapter P of chapter 1 of such Code is amended to
5 read as follows:

“Sec. 1201. Capital gains deduction.

“Sec. 1202. Small business stock eligible for preferential rate.”

6 (d) **EFFECTIVE DATES.—**

7 (1) **IN GENERAL.—**Except as otherwise pro-
8 vided in this subsection, the amendments made by
9 this section shall apply to taxable years ending after
10 December 31, 1996.

11 (2) **REPEAL OF SECTION 1(h).—**The amend-
12 ments made by subsection (c)(1) shall apply to tax-
13 able years beginning after January 1, 1997.

14 (3) **CONTRIBUTIONS.—**The amendment made
15 by subsection (c)(4) shall apply only to contributions
16 on or after January 1, 1997.

17 (4) **USE OF LONG-TERM LOSSES.—**The amend-
18 ments made by subsection (c)(21) shall apply to tax-
19 able years beginning after December 31, 1997.

20 (5) **WITHHOLDING.—**The amendment made by
21 subsection (c)(25) shall apply only to amounts paid
22 after the date of the enactment of this Act.

23 (6) **COORDINATION WITH PRIOR TRANSITION**
24 **RULE.—**Any amount treated as long-term capital

1 gain by reason of paragraph (3) of section 1122(h)
 2 of the Tax Reform Act of 1986 shall not be taken
 3 into account for purposes of applying section 1201
 4 of the Internal Revenue Code of 1986 (as added by
 5 this section).

6 **SEC. 102. INDEXING OF CERTAIN ASSETS ACQUIRED AFTER**
 7 **DECEMBER 31, 1996, FOR PURPOSES OF DE-**
 8 **TERMINING GAIN OR LOSS.**

9 (a) IN GENERAL.—Part II of subchapter O of chap-
 10 ter 1 of the Internal Revenue Code of 1986 (relating to
 11 basis rules of general application) is amended by inserting
 12 after section 1021 the following new section:

13 **“SEC. 1022. INDEXING OF CERTAIN ASSETS ACQUIRED**
 14 **AFTER DECEMBER 31, 1996, FOR PURPOSES**
 15 **OF DETERMINING GAIN OR LOSS.**

16 “(a) GENERAL RULE.—

17 “(1) INDEXED BASIS SUBSTITUTED FOR AD-
 18 JUSTED BASIS.—Except as otherwise provided in
 19 this subsection, if an indexed asset which has been
 20 held for more than 3 years is sold or otherwise dis-
 21 posed of, for purposes of this title the indexed basis
 22 of the asset shall be substituted for its adjusted
 23 basis.

24 “(2) EXCEPTION FOR DEPRECIATION, ETC.—

25 The deductions for depreciation, depletion, and am-

1 ortization shall be determined without regard to the
 2 application of paragraph (1) to the taxpayer or any
 3 other person.

4 “(b) INDEXED ASSET.—

5 “(1) IN GENERAL.—For purposes of this sec-
 6 tion, the term ‘indexed asset’ means—

7 “(A) common stock in a C corporation
 8 (other than a foreign corporation), and

9 “(B) tangible property,
 10 which is a capital asset or property used in the trade
 11 or business (as defined in section 1231(b)).

12 “(2) STOCK IN CERTAIN FOREIGN CORPORA-
 13 TIONS INCLUDED.—For purposes of this section—

14 “(A) IN GENERAL.—The term ‘indexed
 15 asset’ includes common stock in a foreign cor-
 16 poration which is regularly traded on an estab-
 17 lished securities market.

18 “(B) EXCEPTION.—Subparagraph (A)
 19 shall not apply to—

20 “(i) stock of a foreign investment
 21 company (within the meaning of section
 22 1246(b)),

23 “(ii) stock in a passive foreign invest-
 24 ment company (as defined in section
 25 1296),

1 “(iii) stock in a foreign corporation
2 held by a United States person who meets
3 the requirements of section 1248(a)(2),
4 and

5 “(iv) stock in a foreign personal hold-
6 ing company (as defined in section 552).

7 “(C) TREATMENT OF AMERICAN DEPOSI-
8 TORY RECEIPTS.—An American depository re-
9 ceipt for common stock in a foreign corporation
10 shall be treated as common stock in such cor-
11 poration.

12 “(c) INDEXED BASIS.—For purposes of this sec-
13 tion—

14 “(1) GENERAL RULE.—The indexed basis for
15 any asset is—

16 “(A) the adjusted basis of the asset, in-
17 creased by

18 “(B) the applicable inflation adjustment.

19 “(2) APPLICABLE INFLATION ADJUSTMENT.—
20 The applicable inflation adjustment for any asset is
21 an amount equal to—

22 “(A) the adjusted basis of the asset, multi-
23 plied by

24 “(B) the percentage (if any) by which—

1 “(i) the gross domestic product
2 deflator for the last calendar quarter end-
3 ing before the asset is disposed of, exceeds

4 “(ii) the gross domestic product
5 deflator for the last calendar quarter end-
6 ing before the asset was acquired by the
7 taxpayer.

8 The percentage under subparagraph (B) shall be
9 rounded to the nearest $\frac{1}{10}$ of 1 percentage point.

10 “(3) GROSS DOMESTIC PRODUCT DEFLATOR.—

11 The gross domestic product deflator for any cal-
12 endar quarter is the implicit price deflator for the
13 gross domestic product for such quarter (as shown
14 in the last revision thereof released by the Secretary
15 of Commerce before the close of the following cal-
16 endar quarter).

17 “(d) SUSPENSION OF HOLDING PERIOD WHERE DI-
18 MINISHED RISK OF LOSS; TREATMENT OF SHORT
19 SALES.—

20 “(1) IN GENERAL.—If the taxpayer (or a relat-
21 ed person) enters into any transaction which sub-
22 stantially reduces the risk of loss from holding any
23 asset, such asset shall not be treated as an indexed
24 asset for the period of such reduced risk.

25 “(2) SHORT SALES.—

1 “(A) IN GENERAL.—In the case of a short
2 sale of an indexed asset with a short sale period
3 in excess of 3 years, for purposes of this title,
4 the amount realized shall be an amount equal
5 to the amount realized (determined without re-
6 gard to this paragraph) increased by the appli-
7 cable inflation adjustment. In applying sub-
8 section (c)(2) for purposes of the preceding sen-
9 tence, the date on which the property is sold
10 short shall be treated as the date of acquisition
11 and the closing date for the sale shall be treat-
12 ed as the date of disposition.

13 “(B) SHORT SALE PERIOD.—For purposes
14 of subparagraph (A), the short sale period be-
15 gins on the day that the property is sold and
16 ends on the closing date for the sale.

17 “(e) TREATMENT OF REGULATED INVESTMENT
18 COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—

19 “(1) ADJUSTMENTS AT ENTITY LEVEL.—

20 “(A) IN GENERAL.—Except as provided in
21 subparagraph (B), the adjustment under sub-
22 section (a) shall be allowed to any qualified in-
23 vestment entity (including for purposes of de-
24 termining the earnings and profits of such en-
25 tity).

1 “(B) EXCEPTION FOR QUALIFICATION
2 PURPOSES.—This section shall not apply for
3 purposes of sections 851(b) and 856(c).

4 “(2) ADJUSTMENTS TO INTERESTS HELD IN
5 ENTITY.—

6 “(A) REGULATED INVESTMENT COMPA-
7 NIES.—Stock in a regulated investment com-
8 pany (within the meaning of section 851) shall
9 be an indexed asset for any calendar quarter in
10 the same ratio as—

11 “(i) the average of the fair market
12 values of the indexed assets held by such
13 company at the close of each month during
14 such quarter, bears to

15 “(ii) the average of the fair market
16 values of all assets held by such company
17 at the close of each such month.

18 “(B) REAL ESTATE INVESTMENT
19 TRUSTS.—Stock in a real estate investment
20 trust (within the meaning of section 856) shall
21 be an indexed asset for any calendar quarter in
22 the same ratio as—

23 “(i) the fair market value of the in-
24 dexed assets held by such trust at the close
25 of such quarter, bears to

1 “(ii) the fair market value of all as-
2 sets held by such trust at the close of such
3 quarter.

4 “(C) RATIO OF 80 PERCENT OR MORE.—If
5 the ratio for any calendar quarter determined
6 under subparagraph (A) or (B) would (but for
7 this subparagraph) be 80 percent or more, such
8 ratio for such quarter shall be 100 percent.

9 “(D) RATIO OF 20 PERCENT OR LESS.—If
10 the ratio for any calendar quarter determined
11 under subparagraph (A) or (B) would (but for
12 this subparagraph) be 20 percent or less, such
13 ratio for such quarter shall be zero.

14 “(E) LOOK-THRU OF PARTNERSHIPS.—For
15 purposes of this paragraph, a qualified invest-
16 ment entity which holds a partnership interest
17 shall be treated (in lieu of holding a partnership
18 interest) as holding its proportionate share of
19 the assets held by the partnership.

20 “(3) TREATMENT OF RETURN OF CAPITAL DIS-
21 TRIBUTIONS.—Except as otherwise provided by the
22 Secretary, a distribution with respect to stock in a
23 qualified investment entity which is not a dividend
24 and which results in a reduction in the adjusted
25 basis of such stock shall be treated as allocable to

1 stock acquired by the taxpayer in the order in which
2 such stock was acquired.

3 “(4) QUALIFIED INVESTMENT ENTITY.—For
4 purposes of this subsection, the term ‘qualified in-
5 vestment entity’ means—

6 “(A) a regulated investment company
7 (within the meaning of section 851), and

8 “(B) a real estate investment trust (within
9 the meaning of section 856).

10 “(f) OTHER PASS-THRU ENTITIES.—

11 “(1) PARTNERSHIPS.—

12 “(A) IN GENERAL.—In the case of a part-
13 nership, the adjustment made under subsection
14 (a) at the partnership level shall be passed
15 through to the partners.

16 “(B) SPECIAL RULE IN THE CASE OF SEC-
17 TION 754 ELECTIONS.—In the case of a transfer
18 of an interest in a partnership with respect to
19 which the election provided in section 754 is in
20 effect—

21 “(i) the adjustment under section
22 743(b)(1) shall, with respect to the trans-
23 feror partner, be treated as a sale of the
24 partnership assets for purposes of applying
25 this section, and

1 “(ii) with respect to the transferee
2 partner, the partnership’s holding period
3 for purposes of this section in such assets
4 shall be treated as beginning on the date
5 of such adjustment.

6 “(2) S CORPORATIONS.—In the case of an S
7 corporation, the adjustment made under subsection
8 (a) at the corporate level shall be passed through to
9 the shareholders.

10 “(3) COMMON TRUST FUNDS.—In the case of a
11 common trust fund, the adjustment made under sub-
12 section (a) at the trust level shall be passed through
13 to the participants.

14 “(g) DISPOSITIONS BETWEEN RELATED PERSONS.—

15 “(1) IN GENERAL.—This section shall not apply
16 to any sale or other disposition of property between
17 related persons except to the extent that the basis
18 of such property in the hands of the transferee is a
19 substituted basis.

20 “(2) RELATED PERSONS DEFINED.—For pur-
21 poses of this section, the term ‘related persons’
22 means—

23 “(A) persons bearing a relationship set
24 forth in section 267(b), and

1 “(B) persons treated as single employer
2 under subsection (b) or (c) of section 414.

3 “(h) TRANSFERS TO INCREASE INDEXING ADJUST-
4 MENT.—If any person transfers cash, debt, or any other
5 property to another person and the principal purpose of
6 such transfer is to secure or increase an adjustment under
7 subsection (a), the Secretary may disallow part or all of
8 such adjustment or increase.

9 “(i) SPECIAL RULES.—For purposes of this section—

10 “(1) TREATMENT OF IMPROVEMENTS, ETC.—If
11 there is an addition to the adjusted basis of any tan-
12 gible property or of any stock in a corporation dur-
13 ing the taxable year by reason of an improvement to
14 such property or a contribution to capital of such
15 corporation—

16 “(A) such addition shall never be taken
17 into account under subsection (c)(1)(A) if the
18 aggregate amount thereof during the taxable
19 year with respect to such property or stock is
20 less than \$1,000, and

21 “(B) such addition shall be treated as a
22 separate asset acquired at the close of such tax-
23 able year if the aggregate amount thereof dur-
24 ing the taxable year with respect to such prop-
25 erty or stock is \$1,000 or more.

1 A rule similar to the rule of the preceding sentence
2 shall apply to any other portion of an asset to the
3 extent that separate treatment of such portion is ap-
4 propriate to carry out the purposes of this section.

5 “(2) ASSETS WHICH ARE NOT INDEXED ASSETS
6 THROUGHOUT HOLDING PERIOD.—The applicable in-
7 flation ratio shall be appropriately reduced for peri-
8 ods during which the asset was not an indexed asset.

9 “(3) TREATMENT OF CERTAIN DISTRIBUTIONS.—A distribution with respect to stock in a
10 corporation which is not a dividend shall be treated
11 as a disposition.
12

13 “(4) SECTION CANNOT INCREASE ORDINARY
14 LOSS.—To the extent that (but for this paragraph)
15 this section would create or increase a net ordinary
16 loss to which section 1231(a)(2) applies or an ordi-
17 nary loss to which any other provision of this title
18 applies, such provision shall not apply. The taxpayer
19 shall be treated as having a long-term capital loss in
20 an amount equal to the amount of the ordinary loss
21 to which the preceding sentence applies.

22 “(5) ACQUISITION DATE WHERE THERE HAS
23 BEEN PRIOR APPLICATION OF SUBSECTION (a)(1)
24 WITH RESPECT TO THE TAXPAYER.—If there has
25 been a prior application of subsection (a)(1) to an

1 asset while such asset was held by the taxpayer, the
 2 date of acquisition of such asset by the taxpayer
 3 shall be treated as not earlier than the date of the
 4 most recent such prior application.

5 “(6) COLLAPSIBLE CORPORATIONS.—The appli-
 6 cation of section 341(a) (relating to collapsible cor-
 7 porations) shall be determined without regard to this
 8 section.

9 “(j) REGULATIONS.—The Secretary shall prescribe
 10 such regulations as may be necessary or appropriate to
 11 carry out the purposes of this section.”

12 (b) CLERICAL AMENDMENT.—The table of sections
 13 for part II of subchapter O of chapter 1 is amended by
 14 inserting after the item relating to section 1021 the follow-
 15 ing new item:

 “Sec. 1022. Indexing of certain assets acquired after December
 31, 1996, for purposes of determining gain or
 loss.”

16 (c) EFFECTIVE DATE.—

17 (1) IN GENERAL.—The amendments made by
 18 this section shall apply to the disposition of any
 19 property the holding period of which begins after
 20 December 31, 1996.

21 (2) CERTAIN TRANSACTIONS BETWEEN RELAT-
 22 ED PERSONS.—The amendments made by this sec-
 23 tion shall not apply to the disposition of any prop-
 24 erty acquired after December 31, 1996, from a re-

1 lated person (as defined in section 1022(g)(2) of the
2 Internal Revenue Code of 1986, as added by this
3 section) if—

4 (A) such property was so acquired for a
5 price less than the property's fair market value,
6 and

7 (B) the amendments made by this section
8 did not apply to such property in the hands of
9 such related person.

10 (d) ELECTION TO RECOGNIZE GAIN ON ASSETS
11 HELD ON JANUARY 1, 1997.—For purposes of the Inter-
12 nal Revenue Code of 1986—

13 (1) IN GENERAL.—A taxpayer may elect to
14 treat—

15 (A) any readily tradable stock (which is an
16 indexed asset) held by such taxpayer on Janu-
17 ary 1, 1997, and not sold before the next busi-
18 ness day after such date, as having been sold
19 on such next business day for an amount equal
20 to its closing market price on such next busi-
21 ness day (and as having been reacquired on
22 such next business day for an amount equal to
23 such closing market price), and

24 (B) any other indexed asset held by the
25 taxpayer on January 1, 1997, as having been

1 sold on such date for an amount equal to its
2 fair market value on such date (and as having
3 been reacquired on such date for an amount
4 equal to such fair market value).

5 (2) TREATMENT OF GAIN OR LOSS.—

6 (A) Any gain resulting from an election
7 under paragraph (1) shall be treated as received
8 or accrued on the date the asset is treated as
9 sold under paragraph (1) and shall be recog-
10 nized notwithstanding any provision of the In-
11 ternal Revenue Code of 1986.

12 (B) Any loss resulting from an election
13 under paragraph (1) shall not be allowed for
14 any taxable year.

15 (3) ELECTION.—An election under paragraph
16 (1) shall be made in such manner as the Secretary
17 may prescribe and shall specify the assets for which
18 such election is made. Such an election, once made
19 with respect to any asset, shall be irrevocable.

20 (4) READILY TRADABLE STOCK.—For purposes
21 of this subsection, the term “readily tradable stock”
22 means any stock which, as of January 1, 1997, is
23 readily tradable on an established securities market
24 or otherwise.

1 (e) TREATMENT OF PRINCIPAL RESIDENCES.—Prop-
 2 erty held and used by the taxpayer on January 1, 1997,
 3 as his principal residence (within the meaning of section
 4 1034 of the Internal Revenue Code of 1986) shall be
 5 treated—

6 (1) for purposes of subsection (c)(1) of this sec-
 7 tion and section 1022 of such Code, as having a
 8 holding period which begins on January 1, 1997,
 9 and

10 (2) for purposes of section 1022(c)(2)(B)(ii) of
 11 such Code, as having been acquired on January 1,
 12 1997.

13 Subsection (d) shall not apply to property to which this
 14 subsection applies.

15 **SEC. 103. CAPITAL LOSS DEDUCTION ALLOWED WITH RE-**
 16 **SPECT TO SALE OR EXCHANGE OF PRINCIPAL**
 17 **RESIDENCE.**

18 (a) IN GENERAL.—Subsection (c) of section 165 of
 19 the Internal Revenue Code of 1986 (relating to limitation
 20 on losses of individuals) is amended by striking “and” at
 21 the end of paragraph (2), by striking the period at the
 22 end of paragraph (3) and inserting “; and”, and by adding
 23 at the end the following new paragraph:

1 “(4) losses arising from the sale or exchange of
 2 the principal residence (within the meaning of sec-
 3 tion 1034) of the taxpayer.”

4 (b) EFFECTIVE DATE.—The amendment made by
 5 subsection (a) shall apply to sales and exchanges after De-
 6 cember 31, 1996, in taxable years ending after such date.

7 **TITLE II—CREDITS FOR** 8 **FAMILIES**

9 **SEC. 201. FAMILY TAX CREDIT.**

10 (a) IN GENERAL.—Subpart A of part IV of sub-
 11 chapter A of chapter 1 of the Internal Revenue Code of
 12 1986 is amended by inserting after section 23 the follow-
 13 ing new section:

14 **“SEC. 24. FAMILY TAX CREDIT.**

15 “(a) ALLOWANCE OF CREDIT.—There shall be al-
 16 lowed as a credit against the tax imposed by this chapter
 17 for the taxable year an amount equal to \$500 multiplied
 18 by the number of qualifying children of the taxpayer.

19 “(b) QUALIFYING CHILD.—For purposes of this
 20 section—

21 “(1) IN GENERAL.—The term ‘qualifying child’
 22 means any individual if—

23 “(A) the taxpayer is allowed a deduction
 24 under section 151 with respect to such individ-
 25 ual for such taxable year,

1 “(B) such individual has not attained the
 2 age of 18 as of the close of the calendar year
 3 in which the taxable year of the taxpayer be-
 4 gins, and

5 “(C) such individual bears a relationship to
 6 the taxpayer described in section 32(c)(3)(B)
 7 (determined without regard to clause (ii) there-
 8 of).

9 “(2) EXCEPTION FOR CERTAIN NONCITIZENS.—
 10 The term ‘qualifying child’ shall not include any in-
 11 dividual who would not be a dependent if the first
 12 sentence of section 152(b)(3) were applied without
 13 regard to all that follows ‘resident of the United
 14 States’.”

15 (b) CONFORMING AMENDMENT.—The table of sec-
 16 tions for subpart A of part IV of subchapter A of chapter
 17 1 of such Code is amended by inserting after the item
 18 relating to section 23 the following new item:

 “Sec. 24. Family tax credit.”

19 (c) EFFECTIVE DATE.—The amendments made by
 20 this section shall apply to taxable years beginning after
 21 December 31, 1996.

22 **SEC. 202. CREDIT TO REDUCE MARRIAGE PENALTY.**

23 (a) IN GENERAL.—Subpart A of part IV of sub-
 24 chapter A of chapter 1 of the Internal Revenue Code of

1 1986 is amended by inserting after section 24 the follow-
2 ing new section:

3 **“SEC. 24A. CREDIT TO REDUCE MARRIAGE PENALTY.**

4 “(a) ALLOWANCE OF CREDIT.—In the case of a joint
5 return for the taxable year, there shall be allowed as a
6 credit against the tax imposed by this chapter for such
7 taxable year an amount equal to the marriage penalty re-
8 duction credit.

9 “(b) LIMITATIONS.—

10 “(1) DOLLAR LIMITATION.—The amount of
11 credit allowed by subsection (a) for the taxable year
12 shall not exceed \$145.

13 “(2) CREDIT DISALLOWED FOR INDIVIDUALS
14 CLAIMING SECTION 911, ETC.—No credit shall be al-
15 lowed under this section for any taxable year if ei-
16 ther spouse claims the benefits of section 911, 931,
17 or 933 for such taxable year.

18 “(c) MARRIAGE PENALTY REDUCTION CREDIT.—For
19 purposes of this section—

20 “(1) IN GENERAL.—The marriage penalty re-
21 duction credit is an amount equal to the excess (if
22 any) of—

23 “(A) the joint tax amount of the taxpayer,
24 over

1 “(B) the sum of the unmarried tax
2 amounts for each spouse.

3 “(2) UNMARRIED TAX AMOUNT.—For purposes
4 of paragraph (1), the unmarried tax amount, with
5 respect to an individual, is the amount of tax which
6 would be imposed by section 1(c) if such individual’s
7 taxable income were equal to the excess (if any) of—

8 “(A) such individual’s qualified earned in-
9 come for the taxable year, over

10 “(B) the sum of—

11 “(i) an amount equal to the basic
12 standard deduction under section
13 63(c)(2)(C) for the taxable year, plus

14 “(ii) the exemption amount (as de-
15 fined in section 151(d)) for such taxable
16 year.

17 “(3) JOINT TAX AMOUNT.—For purposes of
18 paragraph (1), the joint tax amount is the amount
19 of tax which would be imposed by section 1(a) if the
20 taxpayer’s taxable income were equal to the excess
21 (if any) of—

22 “(A) the taxpayer’s qualified earned in-
23 come for the taxable year, over

24 “(B) the sum of—

1 “(i) an amount equal to the basic
2 standard deduction under section
3 63(c)(2)(A) for the taxable year, plus

4 “(ii) an amount equal to twice the ex-
5 emption amount (as so defined) for such
6 taxable year.

7 “(d) QUALIFIED EARNED INCOME.—For purposes of
8 this section—

9 “(1) IN GENERAL.—The term ‘qualified earned
10 income’ means an amount equal to the excess (if
11 any) of—

12 “(A) the earned income for the taxable
13 year, over

14 “(B) an amount equal to the sum of the
15 deductions described in paragraphs (1), (2),
16 (6), (7), and (12) of section 62(a) to the extent
17 that such deductions are properly allocable to
18 or chargeable against earned income for such
19 taxable year.

20 The amount of qualified earned income shall be de-
21 termined without regard to any community property
22 laws.

23 “(2) EARNED INCOME.—For purposes of para-
24 graph (1)—

1 “(A) IN GENERAL.—The term ‘earned in-
 2 come’ means income which is earned income
 3 within the meaning of section 401(c)(2)(C) or
 4 911(d)(2) (determined without regard to the
 5 phrase ‘not in excess of 30 percent of his share
 6 of the net profits of such trade or business’ in
 7 subparagraph (B) thereof).

8 “(B) EXCEPTION.—Such term shall not in-
 9 clude any amount—

10 “(i) not includible in gross income,

11 “(ii) received as a pension or annuity,

12 “(iii) paid or distributed out of an in-
 13 dividual retirement plan (within the mean-
 14 ing of section 7701(a)(37)),

15 “(iv) received as deferred compensa-
 16 tion, or

17 “(v) received for services performed
 18 by an individual in the employ of his
 19 spouse (within the meaning of section
 20 3121(b)(3)(B)).

21 “(e) AMOUNT OF CREDIT TO BE DETERMINED
 22 UNDER TABLES.—

23 “(1) IN GENERAL.—The amount of the credit
 24 allowed by this section shall be determined under ta-
 25 bles prescribed by the Secretary.

1 “(2) REQUIREMENTS FOR TABLES.—The tables
 2 prescribed under paragraph (1) shall reflect the pro-
 3 visions of subsection (c) and shall round to the near-
 4 est \$25 any amount of credit which is less than the
 5 maximum credit under subsection (b)(1).”

6 (b) CLERICAL AMENDMENT.—The table of sections
 7 for subpart A of part IV of subchapter A of chapter 1
 8 of such Code is amended by inserting after the item relat-
 9 ing to section 24 the following new item:

 “Sec. 24A. Credit to reduce marriage penalty.”

10 (c) EFFECTIVE DATE.—The amendments made by
 11 this section shall apply to taxable years beginning after
 12 December 31, 1996.

13 **TITLE III—PHASE-OUT OF** 14 **ESTATE AND GIFT TAXES**

15 **SEC. 301. PHASE-OUT OF ESTATE AND GIFT TAXES** 16 **THROUGH INCREASE IN UNIFIED ESTATE** 17 **AND GIFT TAX CREDIT.**

18 (a) ESTATE TAX CREDIT.—

19 (1) IN GENERAL.—Section 2010(a) of the In-
 20 ternal Revenue Code of 1986 (relating to unified
 21 credit against estate tax) is amended by striking
 22 “\$192,800” and inserting “the applicable credit
 23 amount”.

24 (2) APPLICABLE CREDIT AMOUNT.— Section
 25 2010 of such Code is amended by redesignating sub-

1 section (c) as subsection (d) and by inserting after
2 subsection (b) the following:

3 “(c) APPLICABLE CREDIT AMOUNT.—For purposes
4 of this section, the applicable credit amount is the amount
5 of the tentative tax which would be determined under the
6 rate schedule set forth in section 2001(c) if the amount
7 with respect to which such tentative tax is to be computed
8 were the applicable exclusion amount determined in ac-
9 cordance with the following table:

“In the case of estates of decedents dying, and gifts made, during:	The applicable exclusion amount is:
1998	\$1,000,000
1999	\$1,500,000
2000	\$2,000,000
2001	\$2,500,000
2002	\$5,000,000.”.

10 (3) CONFORMING AMENDMENTS.—

11 (A) Section 6018(a)(1) of such Code is
12 amended by striking “\$600,000” and inserting
13 “the applicable exclusion amount in effect
14 under section 2010(c) for the calendar year
15 which includes the date of death”.

16 (B) Section 2001(c)(2) of such Code is
17 amended by striking “\$21,040,000” and insert-
18 ing “the amount at which the average tax rate
19 under this section is 55 percent”.

20 (C) Section 2102(c)(3)(A) of such Code is
21 amended by striking “\$192,800” and inserting
22 “the applicable credit amount in effect under

1 section 2010(c) for the calendar year which in-
2 cludes the date of death”.

3 (b) UNIFIED GIFT TAX CREDIT.—Section
4 2505(a)(1) of the Internal Revenue Code of 1986 (relating
5 to unified credit against gift tax) is amended by striking
6 “\$192,800” and inserting “the applicable credit amount
7 in effect under section 2010(c) for such calendar year”.

8 (c) EFFECTIVE DATE.—The amendments made by
9 this section shall apply to the estates of decedents dying,
10 and gifts made, after December 31, 1997.

11 **SEC. 302. REPEAL OF FEDERAL TRANSFER TAXES.**

12 (a) IN GENERAL.—Subtitle B of the Internal Reve-
13 nue Code of 1986 is repealed.

14 (b) EFFECTIVE DATE.—The repeal made by sub-
15 section (a) shall apply to the estates of decedents dying,
16 and gifts and generation-skipping transfers made, after
17 December 31, 2002.

18 (c) TECHNICAL AND CONFORMING CHANGES.—The
19 Secretary of the Treasury or the Secretary’s delegate shall
20 not later than 90 days after the effective date of this sec-
21 tion, submit to the Committee on Ways and Means of the
22 House of Representatives and the Committee on Finance
23 of the Senate a draft of any technical and conforming
24 changes in the Internal Revenue Code of 1986 which are

- 1 necessary to reflect throughout such Code the changes in
- 2 the substantive provisions of law made by this Act.

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